Globalization And The New Economic Model In Latin America

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The import-substituting industrialization (ISI) model of development reached maturity in the 1950s. It began to show signs of decadence in the 1960s when timid reforms were attempted in several countries to address its major weaknesses. In the southern cone (Argentina, Chile and Uruguay), economic reforms became more radical in the 1970s,[1] but elsewhere in Latin America the reform movement stalled and the distortions due to the ISI model became more apparent. By 1982, when the debt crisis struck Latin America, the ISI model was almost completely discredited and there were few voices left to defend it.

The debt crisis in Latin America at the beginning of the 1980s had many causes.[2] The export sector was too small and insufficiently dynamic to finance the increase in debt service payments; the rise in world interest rates pushed up the cost of servicing the debt; and the growth in world liquidity in the 1970s meant that banks started to look for new business in the larger developing countries. The latter would now come to be known as "emerging" countries in order to emphasize the shallowness of their financial markets and their potential for absorbing new inflows of capital.

Extricating Latin America from the debt crisis would prove to be a long and costly affair. The term "lost decade" has rightly been used to describe the stagnation in real GDP per head that resulted in the 1980s from the

adjustment programs adopted throughout the region.[3] These programs were designed to ensure that Latin American countries did not default on their debt and to that extent they were largely successful. However, a high price was paid in terms of the reduction in social spending and the deterioration in infrastructure.

Latin America was in the middle of this adjustment process, when the world economy entered a new phase known as globalization.[4] While product and factor markets had become increasingly integrated after the Second World War, there was a qualitative change in this process starting in the 1980s. Thus, Latin America's efforts to extricate itself from the debt crisis took place just as the rate of growth of world trade and international capital flows started to accelerate.

These new external conditions heavily influenced the nature of Latin America's adjustment process. ISI now looked completely inappropriate. Hostility to foreign direct investment (FDI), so powerful in the 1970s, now appeared reactionary. Latin America, it was argued by the new elite trained in the United States, needed to adjust in a way that allowed the region to participate fully in this new phase of global capitalism through the adoption of neo-liberal policies. The new mood was captured by the phrase "The Washington Consensus," which listed a series of reforms supported not only by the international financial institutions in Washington, D.C., but also by the elites in Latin America.[5]

The first stage of reforms, concentrating on trade and financial market liberalization, was relatively easy to implement and coincided with the return of economic growth to Latin America in the first half of the 1990s. The second stage, concentrating on the rule of law, the quality of institutions and microeconomic reforms, proved much more difficult.[6] The second stage coincided with the end of economic growth and a modest decline in Gross Domestic Product per head in the five years after 1997.[7] This led to a deep sense of pessimism in Latin America by the beginning of the new millennium with opinion divided on whether the region should abandon the neo-liberal model altogether and experiment instead with heterodox policies or persevere with the New Economic Model, as it had come to be called, through widening and deepening the reform process.

This chapter is divided in four parts. The first looks at the new external context after 1980 and examines the main trends of relevance to Latin America. The second explores the Latin American response to globalization from the mid-1980s to the present. The third part examines the outcome of the Latin American response in terms of economic welfare. The conclusions are presented in the final part.

The External Context <A>

Before the First World War, the world economy had been relatively open. Tariff rates were modest, non-tariff barriers were not as yet a major problem, there were few restrictions on capital flows and even labor was free to migrate to many countries. As a result, in this earlier phase of

“globalization”, trade was often a very high proportion of GDP, foreign capital flows represented a significant share of gross capital formation and the foreign-born often represented a large minority of the labor force.[8]

The openness of the global economic system ended in 1914 and was only partially restored in the 1920s. New restrictions on trade and factor movements were applied in the 1930s. By the time of the Second World War, despite the efforts of the United States to restore trade liberalization through bilateral treaties, the world economy was probably less integrated than at any time in the previous century.

The Bretton Woods conference in 1944, leading to the foundation of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (universally known as the World Bank), provided part of the institutional framework for lifting restrictions on trade and capital movements (labor movement was no longer on the agenda as a result of the fear of high unemployment in advanced capitalist countries). However, Bretton Woods postponed detailed consideration of the establishment of an International Trade Organization (ITO) that would have had direct responsibility for lowering restrictions on imports.

Frustration at the lack of progress towards an ITO led a small number of countries to hold a conference in Geneva in 1947. This led to the General Agreement on Tariffs and Trade (GATT), which was strictly limited in scope (it had no responsibility for agriculture or services), had no judicial powers (its decisions were non-binding) and failed to win the support of developing

countries (only three Latin American countries joined). Even by its most enthusiastic supporters it was seen as little more than a stop-gap pending the creation of an ITO.[9]

The conference to launch an ITO was held in Havana in 1948 and appeared to have achieved its purpose with fifty-six countries (almost all the members of the United Nations) signing the treaty. However, it was not ratified by the US Congress and never came into force. For almost fifty years the world was left with GATT to oversee the liberalization of trade despite the fact that GATT had never been intended to have more than a temporary role.

Despite its institutional weaknesses, GATT was remarkably successful from the standpoint of its advanced country members.[10] Most of their trade was in manufactured goods with each other and GATT helped to liberalize such trade through a series of negotiations culminating in the Uruguay Round launched in 1986. GATT restricted the use of non-tariff barriers among its members and oversaw the reduction of tariffs.

These changes led to a rapid growth in world trade. Its volume rose faster than real global GDP in almost every year after GATT was created. As a result, trade as a proportion of GDP rose in many countries. This was true of all developed countries, which accounted for some two-thirds of world trade throughout this period, and also of some developing countries -- notably the tiger economies of East Asia.[11] It did not, however, happen in the larger Latin American countries as a result of the continued support for ISI and the resulting bias against exports.

The global recession at the beginning of the 1980s, which contributed substantially to the Latin American debt crisis, took its toll on world trade. However, after a period of stagnation world exports began to grow rapidly (see Figure 1). They doubled in dollar terms between 1986 and 1994 and continued to rise rapidly thereafter.[12] This spectacular growth was only brought to an end by the United States recession in 2001 that marked the end of the information technology boom.

<Insert Figure 1>

The rapid growth in world trade meant that trade as a share of GDP rose significantly. For the world as a whole the ratio rose from 32.5 percent in 1990 to 40 percent in 2001.[13] In the high income countries the ratio jumped from 32.3 to 37.9 percent, while the euro-zone saw the ratio increase from 44.9 to 56.3 percent.[14] In the developing countries, the ratio of trade to GDP jumped from 33.8 to 48.9 percent, a huge increase that was heavily influenced by the emergence of China as a global exporter of the first rank.

If the world economy was more open to trade at the end of the twentieth century than fifty years before, it was not necessarily more open than in 1900. There are some countries, notably the United Kingdom and Japan, where trade is a lower of proportion of GDP today than a century ago. However, GDP is now dominated by services - not goods - and many of these services are non-traded. When the comparison is made between trade in goods and goods GDP, the evidence suggests strongly that the world is now more integrated in trade terms than ever before. This ratio increased from 82.3

percent in 1990 to 112.3 percent in 2001 for high income countries and even in low and middle income countries it rose from 74.4 to 93.7 percent.[15]

The greater integration of world product markets is a result of many forces. A major part has been played by GATT culminating in the Uruguay Round. The latter, the most ambitious of all the GATT rounds, was concluded in 1993 and led to the creation of the World Trade Organization (WTO) in 1995. This institution has many of the features expected of the ITO fifty years before. It has responsibility for agriculture and services as well as manufactures, it includes most developing countries, and it has binding powers in the case of disputes.[16]

Under GATT/WTO tariff rates have tumbled. The weighted mean tariff in the United States in 2001 stood at 1.8 percent. In the European Union it fell from 3.7 percent in 1988 to 2.6 percent in 2001. Even in Japan, despite its alleged proclivity for protectionism, it had fallen to 2.1 percent by the beginning of the twenty-first century.[17] Just as important, the scourge of non-tariff barriers began to be tackled with the WTO authorized to take whatever steps were necessary to outlaw them. With the exception of trade in agricultural products, where developed country protection for the home market and subsidies for exports remained rife, the trend towards greater global trade liberalization was very marked.

The success of GATT in liberalizing trade in goods and of the WTO in doing the same for services begs the question. Why have these efforts succeeded where previously they failed? The answer is provided by the

dominant role played by multinational corporations (MNCs) whose subsidiaries account for some 60 percent of world trade. There are now some 60,000 MNCs in the world and they are no longer confined to developed countries. Each MNC has an average of eight subsidiaries and these subsidiaries trade with each other so intensively that intra-MNC trade alone represents around 40 percent of world trade.[18]

MNCs and their subsidiaries exchange an array of goods and services that has undermined traditional theories of international trade. The Hecksher-Ohlin theorem, with its emphasis on inter-sectoral trade, no longer holds for much of foreign commerce.[19] Instead of selling each other goods from different industries, countries are selling each other goods and services from the same sectors. This intra-industry trade, in which the subsidiaries of MNCs play a key role, now dominates trade patterns among developed countries and is increasingly important in trade between developed and developing countries. It is even emerging as an important factor in trade among developing countries.[20]

Without the impulse to trade liberalization from the MNCs, it is doubtful if the government negotiators at GATT rounds would have been able to make so much progress. The removal of trade barriers has been a vital part of these companies' strategy as their production processes have become more spatially diffuse. Competition in developed country markets has led to a constant search for greater efficiency and lower costs of production. With a large gap in wage rates between rich and poor countries, a decision by one

MNC to shift part of the production process to developing countries was bound to be followed by others.

The integration of the world economy through trade may be driven primarily by MNCs, but the trade networks now embrace the developing countries. Within the developing world, a special role has been played by East Asia. Beginning with the four dragons (Hong Kong, Singapore, South Korea and Taiwan), the Newly Industrialized Countries (NICs) of East Asia now include Malaysia, Indonesia, Philippines and China. These eight countries have become key locations in global production chains that stretch around the world, making possible rates of growth of real GDP that until the 1997 Asian financial crisis were the highest in the world.

This is the world that Latin America faced as it sought to extricate itself from the debt crisis. While some Asian NICs may have increased indebtedness as fast as in Latin America, they had large and dynamic export sectors that could generate the foreign exchange to service the debt. Their role in the global division of labor meant that current account deficits could be financed through direct foreign investment when portfolio capital was scarce. And their geographical proximity to Japan, the fastest growing advanced economy until the 1990s, provided them with a powerful engine of growth.

The integration of the product markets is an important part of globalization. However, it is not the only part and may not even be the most important. The driving force in modern capitalism is the flow of international capital. These flows dried up almost completely in the 1930s and restrictions

on capital were only slowly lifted after the Second World War. Unlike with trade, there was no gradual process of capital account liberalization and there were also serious reversals as countries faced balance of payments problems. The United States, for example, extended its restrictions on outflows of capital in the 1960s and the United Kingdom did the same in the 1970s.

The Reagan-Thatcher revolution in the 1980s had many characteristics, but one of the most striking was the bonfire of capital account and currency restrictions. Ironically, this took place after the boom in bank lending to Latin America that led to the debt crisis. Yet there can be no doubting the qualitative change that took place in the scale of capital flows in the mid-1980s. Since high income countries are both exporters and importers of capital, the best way to capture this change is by summing the inflows and outflows of all private capital (direct, portfolio and other) and normalizing by expressing the result as a percentage of GDP.

The result is given in Figure 2, where the structural break in the mid-1980s for the high income countries is immediately apparent. From a low of 7.1 percent in 1985, the ratio had jumped to nearly 15 percent by 1995 and nearly 35 percent by 2000. For the countries making up the euro-zone, perhaps the most integrated bloc in the world, the ratio had reached 32.2 percent by the end of the twentieth century. By contrast, the ratio for low income countries remained depressed throughout the period. It was 0.7 percent in 1988 and was only 2.0 percent a decade later. Most of these private gross capital flows went from developed countries to developed countries.

<Insert Figure 2>

The acceleration in private capital flows was not only due to the lifting of restrictions on the capital account of the balance of payments. It was also due to the new international division of labor and the need for MNCs to expand their operations around the world. Direct foreign investment, also measured as the sum of outflows and inflows, shows a similar trend (see Figure 3) rising for high income countries from below two percent of GDP in 1985 to ten percent in 2000. In the United States, where the size of the domestic economy reduces the relative importance of gross capital flows, gross DFI flows represented almost half of all private capital flows by the end of the 1990s.

These DFI flows increased in importance in all regions of the world after the mid-1980s. In middle income countries, they quadrupled as a share of GDP between 1988 and 1998 reaching 1.6 percent. In upper middle income countries they rose even faster to 2.2 percent. Even in low income countries they had risen to nearly one percent in 2001 from 0.2 a decade earlier.[21] No country that was serious about meeting the challenge of globalization could afford to ignore this trend and governments all over the world reformed their legislation on DFI in order to increase their chances of benefiting from the increased mobility of capital.

<Insert Figure 3>

Despite the growing importance of DFI, portfolio capital continued to dominate gross capital flows. Restrictions on the financial sector were lifted in

advanced countries. Mergers and acquisitions within the financial sectors accelerated. Local institutions became regional and regional institutions became global. New financial instruments were pioneered and the bond markets were especially dynamic. Developing countries were redefined as "emerging," "pre-emerging" or "frontier" and pressure built up inside and outside to make the equity markets more liquid and accessible.

The elimination of restrictions on capital movements in developed countries in the 1980s was followed by their elimination in developing countries in the 1990s. The IMF and the World Bank put pressure on borrowing countries to liberalize the capital account of the balance of payments. In many cases this was premature,[22] as Southern Cone countries in Latin America had discovered to their cost at the beginning of the 1980s. Yet these lessons were not heeded and the speed of liberalization was one of the main reasons for the financial crisis that hit Asia in 1997.

The other reason for the Asian financial crisis was the pegging of local currencies to the dollar at a time when the dollar was exceptionally strong. Unlike trade and capital account liberalization, there was no consensus on exchange rate management and the debate has continued to rage in favor of fixed or floating currencies. However, globalization introduced a new element into the debate since closer integration of trade and factor markets raises the possibility of currency substitution. A number of developing countries have therefore experimented with new exchange rate arrangements ranging from

currency boards (e.g. Hong Kong) to adoption of foreign currencies (e.g. Montenegro).

Latin America's efforts to exit from the debt crisis had to take these new circumstances into account. The short-run need to adjust the external sector to free up resources with which to service the foreign debt was overshadowed by the medium-term requirement of adapting to the challenge of globalization. How this twin challenge was met is the subject matter of the second part of this chapter.

The Latin American Response <A>

The need to save foreign exchange in order to meet the rising costs of debt service led Latin American countries at first to increase -- not decrease -- the restrictions on imports. After the Mexican government threatened to default in August 1982, tariffs were raised in many countries and non-tariff barriers (NTBs) increased sharply. In addition, output was falling as a result of the decline in the terms of trade, the global recession, and the tightening of fiscal policy.[23]

Imports did indeed fall, but so did the value of exports. The resulting small trade surplus was insufficient to service the debt and Latin American countries were dependent on inflows of capital from official sources coupled with creative accounting by the international private creditors in order to avoid falling into default. The net transfer of resources turned negative as debt service payments far exceeded the net inflow of capital.[24]

The United States, as might have been expected, took the lead in co-coordinating the response of the creditors (private and official) to the Latin American debt crisis. The first public recognition that the position of the debtors was unsustainable came in 1985 with the announcement of the Baker Plan. Named after the US Secretary of the Treasury at the time, the Baker Plan identified the crisis as one of liquidity rather than solvency, but the additional resources provided under the scheme were quite inadequate. By February 1987 Brazil had declared a moratorium and international banks rushed to declare their Latin American loans as value-impaired. This forced them to make loan-loss provisions, but these were cushioned by permission from the fiscal authorities in their countries to write them off against tax.

The Baker Plan was followed by the Brady Plan in 1989, named after Nicholas Brady who succeeded James Baker as US Treasury Secretary. This scheme was more radical as it offered private creditors a menu from which they could choose provided that they had met the conditions for adjustment stabilization agreed with the IMF. The most popular choice was to exchange the nominal value of bank debt for bonds with a lower face value with collateral provided by zero-coupon Treasury bills. These Brady bonds, as they were immediately dubbed, allowed banks to exit from their exposure to Latin America and therefore brought to an end the 1980s debt crisis.

It did not, of course, end the problem of indebtedness. The debt now took the form of bonds rather than bank loans, but the export sector in most countries was still very small in relation to both the size of the economy and

the debt itself. Indeed, many commentators at the time argued that the Brady Plan, like the Baker Plan, was too little and too late.

We shall never know whether the critics were right or wrong as the Brady Plan was soon overtaken by events. For reasons discussed below, the main Latin American countries were suddenly the beneficiary of new capital inflows starting in 1990 that reversed the negative net transfer of resources. Instead of foreign currency scarcity, there was foreign exchange abundance. Some governments even issued new bonds in order to retire the Brady bonds.

The result was a surge in external indebtedness just after the Brady Plan was supposed to have ended the debt crisis (see Figure 4). The main Latin American countries experienced a build-up of debt that was even greater than in the period before 1982. This time the creditors were largely anonymous, as they were bondholders rather than banks, making a co-coordinated creditor response almost impossible.

<Insert Figure 4>

The capital inflows in the first half of the 1990s were mainly portfolio. Only one-third consisted of Direct Foreign Investment. A few countries, notably Chile, adopted restrictions on short-term capital inflows, but most were only too happy to capture whatever foreign resources were available.[25] The result was a dangerous increase in speculative capital and an excessive dependence on foreign capital for the financing of domestic investment.

The first evidence that the increase in debt was unsustainable came with the Mexican financial crisis in 1994. Dubbed the first such crisis of the

twenty-first century by Michel Camdessus (the IMF's Director at the time), the Mexican crisis led to an unprecedented rescue package mounted by the IMF and co-coordinated by the United States. Mexico avoided default and the spreads on Latin American bonds returned to their previous levels, but it was an ominous warning of the difficulties that lay ahead.

The *tequila* crisis, as it was known, only temporarily reversed the net inflow of capital to Latin America. This continued almost unabated until the end of 1998. At this point the Asian financial crisis, coupled with the Russian default in August 1998, led to a reassessment by creditors of Latin American risk. Thus, the ability of governments and companies in Latin America to borrow their way out of difficulty came to an end as the century closed.[26]

There have been three circumstances under which Latin American countries have been able to cope with the new debt reality. First, some countries (see below) have been able to increase the size of their export sectors in relation to GDP. Just as South Korea escaped the 1980s debt crisis because it was able to export its way out of trouble, so a handful of Latin American countries have been able to bring down the ratio of debt and debt servicing to exports through rapid growth of the export sector.

Secondly, some countries -- for reasons explored below -- have been able to finance a growing proportion of their current account deficits through DFI rather than debt. The inflows of DFI were linked to the process of privatization in Latin America, reaching a peak in 1998. They declined rapidly

thereafter, however, as the opportunities for privatization came to an end in most countries.

Thirdly, many Latin American countries are too small to be attractive to foreign private creditors. Portfolio investors will not invest in equity markets with small turnover and little liquidity. Governments of such countries find it difficult to issue bonds. As a result, smaller Latin American countries have been dependent on official sources of capital, which is subject to conditions as well as being rationed.

The generalized debt crisis of the 1980s did not, therefore, repeat itself in the 1990s, even if some countries had very serious debt problems. Brazil came close to a moratorium in 1998 before the devaluation of the *real* in January 1999 and again in 2002 in the run-up to the presidential elections. Ecuador defaulted on its Brady bonds in 2000 and Argentina defaulted on all its foreign debt at the end of 2001. And Cuba's debt problems have been so severe that it has been in arrears with almost all its creditors since the early 1980s.

The policies to tackle the debt crisis were being adopted at the same time as globalization was advancing in the rest of the world. This made it particularly difficult to meet the challenge of globalization and raised the possibility of contradictory policies. Tariffs, for example, needed to be raised to create a trade surplus to meet debt service payments, but needed to be lowered to promote the trade liberalization favored by globalization.

The Southern Cone countries had experimented with neo-liberal policies in the 1970s, but these had been overwhelmed by the debt crisis and went into reverse. It was not until 1984 that Chile once again felt confident enough to return to the trade liberalization policies she had adopted so aggressively after 1975. Ecuador flirted briefly with tariff reductions in 1984, but Congress -- not for the first time in recent Ecuadorian history -- stymied the neo-liberal instincts of the executive.

The most important shift away from ISI, however, came in Mexico in 1985 with the decision by the de la Madrid administration (1982-8) to join GATT. At a stroke, the quantitative restrictions that had underpinned Mexican industry for decades came under fire and a program of tariff reductions was also agreed. Those other Latin American countries that had not yet applied to GATT all did so in the following years so that by the end of the century every Latin American and Caribbean country except the Bahamas were members of the WTO (GATT's successor).

The Mexican government's decision had less to do with globalization, a word that had only just been coined, and more to do with the need to expand the export sector. Paradoxical though it may seem, reducing tariffs and NTBs is often the first step towards promoting exports. The reason is the impact of import restrictions on the exchange rate, which tends to become over-valued, and the increase in costs of export production from high tariffs on imported inputs.

Mexico's trade liberalization policies led to a deepening of the trade links with the United States. The non-oil share of exports, most of which goes to the United States, went from 20 percent in the early 1980s to 80 percent in the early 1990s. At that point Mexico began to negotiate its entry into the free trade agreement launched by the US and Canada in 1989. The result was NAFTA, which came into force on 1 January 1994.[27] This has led to a further deepening of the trade ties between Mexico and the United States to the point where Mexico now accounts for half of all trade between the United States and Latin America.[28]

This bilateral trade is not, however, typical of trade between the US and Latin America. Mexico's trade with the United States consists mainly of manufactured goods and is largely intra-industry. Indeed, eight of the top eleven Mexican imports from the United States now feature in the top eleven Mexican exports to the United States.[29] And Mexico has become very dependent on exports to the United States, which accounted for 31 percent of GDP in 2000.[30] Not surprisingly, Mexico went into recession in 2001 as a result of the economic slowdown in its northern neighbor.

Elsewhere in Latin America, trade liberalization has been less successful. Tariffs have been reduced everywhere and some countries such as Bolivia and Chile have adopted a uniform tariff. However, export performance has been overwhelmingly affected by the value of the real exchange rate. This has often moved in the "wrong" direction. Thus, when trade barriers are

reduced, the real exchange rate should depreciate, providing an additional incentive to exporters.

Why was the movement in the real exchange rate so perverse? In many countries trade liberalization occurred just as capital returned to Latin America. The net inflows pushed up the value of the real exchange rate and encouraged imports, but not exports. This was the problem in Mexico from 1990 to 1994, in Argentina after 1991 and Brazil from 1994 to 1998. As a result, export performance in many countries has been modest and Latin America's increasing share of world exports is mainly due to Mexico.

The disappointing performance of the export sector was one of the reasons for the re-evaluation of regional integration. The schemes established in the 1960s had been discredited by the debt crisis, as they were so strongly associated with ISI -- albeit at the regional level. However, a new attempt was made in the 1990s to launch integration schemes that would promote exports without encouraging protection against third countries. The Central American Common Market was re-launched in 1990, the Caribbean Community (CARICOM) in 1992 and the Andean Pact (renamed the Andean Community) in 1995.[31]

The most innovative new integration scheme was the Mercado Comun del Sur (MERCOSUR), formally adopted in 1991. Linking Argentina, Brazil, Paraguay, and Uruguay (Bolivia and Chile became associate members in 1996), it had a clear political purpose as well as economic objectives. When the Clinton administration announced in 1994 US support for a Free Trade

Area of the Americas (FTAA), MERCOSUR was quick to negotiate as a bloc in order to prevent the United States from dominating the hemispheric agenda on regional integration. However, MERCOSUR's early promise was not fulfilled. The common external tariff was never adopted in full and the scheme suffered from the economic instability brought about both by external shocks and the absence of macroeconomic co-ordination.[32]

Trade liberalization is only one of the ways in which Latin America has adjusted to globalization. Just as important has been the liberalization of the capital account of the balance of payments and a new approach to foreign capital. The old hostility to DFI, so strong in the 1970s, has gone and country after country has introduced new legislation to promote DFI with very few sectors or activities reserved for domestic capital.

As part of this new approach to DFI, all Latin American governments have divested themselves of state-owned enterprises (SOEs). A few of these behemoths still exist, particularly in the oil industry, but they are now the exception rather than the rule. Even Cuba has participated in this process of privatization with the added twist that the purchase of the assets is restricted to foreigners. Elsewhere domestic private groups have been active in the purchase of SOEs, but so have foreigners. As a result, the stock of DFI has surged in public utilities, airlines, railways and steel companies and other sectors where SOEs were previously common.

It is perhaps in the mining sector that the transformation has been most marked. Latin America has a long history of discrimination against DFI in

mining, going back to the formation of YPF (an oil monopoly) by the Argentine state in 1922 if not before. The rationale for this was complex and included resentment at foreign company practices, rent-seeking by cash-strapped governments and nationalism. Yet, nearly two centuries after the end of colonialism in most of Latin America, it is still the mineral resources that most attract foreign companies. Thus, Latin America had little choice but to liberalize access of foreign capital into the mining sector if it wanted to receive DFI.

The liberalization of the capital account has not been limited to DFI. On the contrary, for most of the 1990s the foreign investment coming to Latin America has been private portfolio capital. This has not been in the form of bank lending, the dominant form of foreign capital in the 1970s, but bonds and to a lesser extent equity. Trade credits from banks and other short-term loans have continued, but in general the international banks were only too quick to seize the opportunity for exit offered by the Brady bonds.

The growth of the international bond market has been dramatic and the main Latin American governments and companies tapped into it with relative ease. They were given a head start by the issuance of Brady bonds that transformed what had become almost an exotic form of Latin American debt into one with broad appeal. Furthermore, this foreign currency market was open to nationals (both companies and individuals) providing a welcome hedge against devaluation and an opportunity for portfolio diversification.

The international bond markets offered Latin America an opportunity to issue debt at lower real interest rates than in the shallow domestic financial markets. This was so even after making allowance for expected exchange rate movements provided that the country risk premium could be held to a moderate level. Governments therefore put a huge effort into reducing the risk premium through sophisticated “road shows” in New York and London as well as greater transparency on the fiscal accounts and rules on company disclosures.

These efforts did not go unrewarded by the ratings agencies. By the beginning of 2003 Chile had been given A- on its long-term foreign currency debt, Colombia -- despite the high levels of domestic violence -- received BB while El Salvador, which had been embroiled in civil war as late as the early 1990s, was awarded "BB+."[33] The ratings agencies were more circumspect about the big three (Argentina, Brazil, and Mexico), although Mexico was rewarded with investment grade status during 2000 as the era of the one-party state finally came to an end.

The ratings, modest country risk premiums and low international interest rates all encouraged Latin American governments, as well as larger companies, to switch out of domestic currency debt into foreign bonds. The result was an unhealthy expansion of external indebtedness in many countries, particularly Argentina and Brazil, which were vulnerable to a widening of the risk premium and any unwillingness of the bond markets to refinance. When

Argentine difficulties finally surfaced in 2001, the country was found to account for 25 percent of all emerging market fixed interest debt.

If Latin America's attempts to tap into the international bond market were too successful, the opposite was true of its efforts to attract equity capital. All attempts to broaden the appeal of the local stock markets failed. Only a small number of stocks were listed, most domestic companies preferring to remain 100 percent controlled by their family shareholders. Most of the listed stocks were not actively traded so that liquidity was a serious problem. The larger firms sought a listing as ADRs[34] on the New York exchange and mergers and acquisitions by foreign companies led some of the most important companies to delist. By 2000 only two markets -- São Paulo and Mexico City -- had any appeal for foreign investors and stocks in these markets accounted for 80 to 90 percent of the typical Latin American fund.

Latin America's liberalization of the capital account was therefore less satisfactory than its liberalization of the current account. Many of the smaller countries remained unattractive to foreign capital regardless of what they did, while DFI flowed primarily to mineral extraction and former SOEs. Assembly plants set up by foreign companies flourished in parts of the Caribbean Basin, but this was a reflection of temporary tax breaks in the United States more than anything else.[35] The larger countries, on the other hand, became too dependent on the foreign currency bond market. Mexico was the first to suffer (in 1994), but was rescued by its international creditors and was able to use

currency depreciation to build up a massive export capacity. Argentina and Brazil were not so fortunate.

Latin America's efforts to adjust to globalization through liberalization of the current and capital accounts were matched by reforms to the domestic economy. Indeed, to a large extent the external adjustment required a domestic response. This was particularly true of monetary and fiscal policy where irresponsible behavior was now much more likely to be punished. Thus, high rates of inflation could not be tolerated when tariffs were falling (trade liberalization) and real exchange rates rising (capital inflows).

Monetary policy has been transformed in Latin America in the last twenty years. Central banks have become much more autonomous (e.g. Brazil) and some have been given complete independence (e.g. Mexico). Regulation of the banking systems have been improved and the entry of foreign banks has increased efficiency even if competition is still limited. The ability of the public sector to monetize fiscal deficits has been severely curtailed. The outcome, as we will see in the next section, has been a big fall in inflation in Latin America to rates that have not been seen for decades. Indeed, such has been the improvement in the quality and credibility of monetary policy that nominal exchange rate devaluation is no longer necessarily a guide to the rate of inflation.[36]

The most serious weakness in monetary policy has been the failure to lower the real cost of borrowing. This is partly due to the shallowness of the financial markets, but is also due to the huge spread between borrowing and

lending rates. Indeed, it is not unknown for the real lending rate to be close to zero while the real borrowing rate is above 10 percent. Lack of competition in the financial markets is primarily to blame and this has not yet been overcome through liberalization of the capital account of the balance of payments. In practice, only the largest Latin American companies have access to the international capital market so that small and medium-sized enterprises (SMEs) are restricted to borrowing in the domestic market and are crippled by high rates.

This unsatisfactory state of affairs arises in part because financial institutions have become major creditors to the public sector and are not so dependent on private sector business. As mentioned above, the foreign-currency bonds are often held by domestic agents and these are principally the banks. Thus, the banks benefit from the country risk premium and the banks are also the most likely to hold the domestic currency debt issued by governments.

It might appear from the above that fiscal policy did not improve after the debt crisis. In fact, it did, but it is necessary to distinguish between the primary balance (net of interest payments) and the nominal balance. The primary balance has moved into surplus in most countries, as taxes have been increased, defense spending cut and subsidies to SOEs eliminated. Equity considerations have been largely sacrificed in the search for increased revenues with an emphasis on broad-based sales taxes, particularly value-added tax. And federal countries have made serious efforts to control spending

by provincial governments. However, interest payments on the public debt -- both domestic and foreign -- have remained a major drain on state finances leading to nominal deficits that were sometimes large even when the primary balance was in surplus.

The tightness of fiscal policy, in terms of macroeconomic stability, is more closely approximated by the primary than the nominal balance. Thus, fiscal policy has been restrictive in many countries at the cost of lower investment and also at the expense of social spending. Targeting of social spending on lower income groups, promoted by the World Bank in particular, became more popular and enjoyed some success -- notably in Chile. However, the impact of social spending has not in general improved the secondary distribution of income.[37]

The reasons for this have been complex, but two stand out. First, educational spending on universities -- a large part of the total -- has favored the middle and upper deciles of the income distribution. Secondly, state spending on pensions goes overwhelmingly to the middle classes in Latin America rather than the poor. Although most governments have privatized -- in whole or in part -- their pension systems, there is a long lag before state liabilities cease. The reason is that older workers remain in the state system and continue to benefit until they die.[38]

While something approaching a consensus has developed in relation to fiscal and monetary policy in Latin America since the debt crisis, the same cannot be said about exchange rate policy. All Latin American countries,

except dollarized Panama, devalued in the 1980s and early 1990s in an effort to adjust the external sector both to create resources to service the debt and to promote exports. However, the similarity ends there. One group, led by Argentina, marched resolutely towards fixed currencies and *de facto* dollarization. Another group, led by Chile, adopted a crawling peg with a real exchange rate target. While the third group, led by Mexico after 1994 and joined by Brazil in 1999, opted for exchange rate flexibility.

The first group initially enjoyed great success. Inflation came down to international levels and was accompanied by financial deepening. However, the risk premium did not disappear and a spread remained between domestic and foreign interest rates. Thus, the logic of this group has been to move towards *de jure* dollarization with Ecuador and El Salvador joining Panama. Argentina appeared to be moving in this direction with nearly 70 percent of bank deposits denominated in dollars by the fourth quarter of 2001. However, default on the external debt at the end of 2001 triggered a devaluation of the currency and a difficult period of *pesoification* as the authorities struggled to reverse the dollarization of the 1990s.

The second group also enjoyed initial success in achieving the target. However, the difficulty of attracting foreign capital after the Asian financial crisis led to a dismantling of restrictions on foreign capital inflows and a move towards full currency flexibility. Only the smaller countries, such as Costa Rica, were able to persevere with real exchange rate targeting. Other countries,

including Chile and Colombia, effectively joined the third group at the end of the 1990s.

Thus, Latin America found itself divided into two camps on exchange rate policy. In the fixed exchange rate group, dollarization appeared to be the logical step or at least a monetary union based on a regional currency. In the other group, formal dollarization looked increasingly unlikely, although the dollar was often used in pricing assets. Both groups claimed to be adjusting to globalization, so that at least with respect to exchange rate policy the implications of world economic integration appear to have been ambiguous.

The Outcome

It is not easy at this distance to judge Latin America's economic performance since the debt crisis. Two decades is a short time in economic history and there is a sharp contrast between the adjustment of the 1980s and the recovery of the 1990s. Nevertheless, certain patterns emerge with clarity. In what follows, I will concentrate on growth, trade, capital flows, and inflation. The equity performance is analyzed in Chapter XX and the impact on the environment in XX.

The rate of growth of GDP per head in the two decades since the debt crisis is shown in Table 1. Although there was a modest improvement between the 1980s and the 1990s, the result is not impressive. It can be argued that the long-run performance should not be judged by the 1980s, as this was a period of adjustment to the excesses of ISI and the debt crisis. However, even if the analysis is confined to the period since 1990, the results are still disappointing

with a low average rate of growth of GDP per head (1.2 percent) and a high variance. Furthermore, the five years after 1997 were marked by virtual stagnation in GDP per head in Latin America, leading to it being described as the “lost half-decade.”

Since the mid-1980s only one country (Chile) has been able unambiguously to exceed its performance during the inward-looking phase of development from 1950 to 1980, although the Dominican Republic achieved a very credible annual growth rate in GDP per head in the 1990s (see Table 1).[39] Argentina initially improved its long-run rate of growth of real GDP per head, but this was undermined by a deep recession after 1998.[40] The other cases of superior growth are all rather unusual. El Salvador, for example, grew rapidly in the 1990s, but this was after a long civil war and the rate of growth is heavily influenced by the remittances sent by all those who had left the country for the United States.

<Insert Table 1>

Mexico’s performance has been an illustration of the costs and benefits of globalization. One of the first to adjust, Mexico was also quick to liberalize its current and capital accounts and to integrate its economy into the North American economic space. Although performance could be damaged by domestic mistakes, as in the excessive build-up of debt in the early 1990s, the long-run trend towards a greater dependence on the US market has become clear.

When the US economy performed well, Mexico benefited handsomely. Growth was export-led and export expansion generated a boom in other parts of the economy despite the weak backward linkages from the maquila industry on the northern border. The economy became less dependent on oil and manufactured exports became less dependent on the assembly industry. However, Mexico went into recession as soon as the US economy slowed down. With some 30 percent of its GDP in exports and nearly 90 percent of its exports going to the United States, this was perhaps inevitable. Mexico's economic fortunes are now increasingly bound up with those of the United States.[41]

Argentina's performance has been a case study in the dangers of inconsistent policies. On many criteria, Argentina in the 1990s was the most neo-liberal economy in Latin America with widespread privatization, complete capital account liberalization and a large measure of trade liberalization. Yet the exchange rate policy, under which the local currency was pegged to the US dollar under a virtual currency board regime, imposed fiscal obligations on the government that were never fully respected. The result was a lack of fiscal discipline leading to a massive increase in external debt. As long as the economy grew rapidly, the debt problem could be contained. It became unsustainable, however, when growth stopped after 1998 and the authorities had no instruments at their disposal with which to stimulate the economy.[42]

The other big disappointment has been Brazil. The largest economy in the region, Brazil has consistently failed to achieve its potential. Adjustment and liberalization were delayed until the 1990s so that this harsh judgment may prove premature. However, greater fiscal and monetary responsibility, low inflation, trade and financial liberalization and the promotion of DFI have not yet enabled Brazil to shift to a higher long-run sustainable growth rate.[43]

The obstacles in Brazil are numerous. The rate of investment is held back by low domestic savings, as in so many parts of Latin America and unlike in Asia; foreign capital cannot be relied on to close the gap. High real interest rates discourage borrowing by the private sector for productive purposes. Exports responded only modestly to devaluation and remain less than 10 percent of GDP (compared with over 20 percent in China at the end of the 1990s). Brazil's income inequality, one of the worst in the world, also acts as a break on its economic performance, although this is more controversial. At the very least Brazil does not enjoy the benefits such as high savings rates that are supposed to accompany an unequal distribution of income.

The transition from ISI would have required greater attention to foreign trade with or without globalization. The reason is that Latin America saw its share of world trade decline steadily after 1950 to the point where it had reached a mere 3.5 percent in 1980 (much lower than its share of world population). Although some of this decline could be attributed to a specialization in primary products at a time when primary products trade was

growing less fast than total trade, it was also due to the relentless anti-export bias associated with the inward-looking model of development.

The strategy to reverse the decline in world market share has had two components. First has been the greater attention to the export sector through policies designed to favor traded over non-traded goods and within tradeables to favor exportables over importables. Second has been the desire to diversify exports away from primary products towards manufactured goods and even services.

The results for Latin America as a whole have been impressive, although they are heavily influenced by Mexico. Thus, the share of world exports has indeed increased since the mid-1980s, but this is mainly due to Mexico's export boom. By 2000 Mexico accounted for half of all Latin America's exports. Excluding Mexico, the Latin American performance has been much less satisfactory. However, some smaller countries -- notably Chile, but also Costa Rica -- also increased world market share rapidly.

Aggregate figures for Latin America are always heavily influenced by Brazil and trade is no exception. Thus, the poor performance of Latin America (excluding Mexico) reflects the Brazilian export sector's lack of dynamism. This has been all the more puzzling in view of the increase in export competitiveness after the devaluation in January 1999. The Brazilian authorities tended to blame agricultural protectionism in rich countries for this sad state of affairs, but in truth it has been much more complex.

The diversification of Latin America's exports has been much more satisfactory (see Figure 5). Once again, the results have been heavily influenced by Mexico, but this time they are reinforced by Brazil. Yet in most countries, the contribution of primary products to total exports has been in decline and it must be borne in mind that the statistics in Figure 5 do not include service exports.

<Insert Figure 5>

Diversification has had several causes. In smaller countries it has been helped by the growth of the maquila industry. Haiti, for example, has one of the lowest ratios of primary products to total exports and this is entirely due to the assembly plants exporting light manufactures to the United States. In Costa Rica the establishment by INTEL of a computer chip factory at the end of the 1990s doubled the gross value of exports within two years. In larger countries it also reflects investments by MNCs as part of the production chain linking subsidiaries across the world.

Regional integration has also been an important cause of diversification. The new phase of integration has encouraged the export of manufactured goods to neighboring countries. Indeed, despite the absence of formal discrimination against agricultural products, almost all intra-regional trade in Latin America is in manufactures and a growing proportion of this is intra-industry trade as well. However, the impact of regional integration would appear to be quite limited as each scheme -- with the notable exception of NAFTA -- has found it difficult to increase the share of total trade that is intra-

regional trade. This peaked at 20 percent in MERCOSUR, 15 percent in the CACM and ten percent in the Andean Community and CARICOM.

Capital account liberalization and other measures have helped to bring foreign investment to Latin America. There has been a big increase in net private capital flows to the region (see Figure 6), which once again reflects the size and importance of the main economies (not only Brazil and Mexico, but this time also Argentina). These annual flows help to explain the big increase in total external debt, which by 2000 had reached nearly $800 billion (see Figure 4). Considering that the stock of debt had been “only” $258 billion in 1980, shortly before the debt crisis was triggered, and that the economic performance after 1980 was far from stellar, it is clear that the increase in debt was neither justified nor sustainable.

<Insert Figure 6>

Direct foreign investment (DFI) was not attracted to Latin America in the 1980s. However, that changed in the 1990s and by the end of the decade the annual flow had increased significantly and accounted for two-thirds of the inflow of net private capital. As a result, DFI raised its contribution to domestic investment from less than 5 percent in 1980 to nearly 20 percent in 2000.[44] This ratio, similar to what is found in South-East Asia, has been welcomed by governments in the region, but it came too late to prevent the build- up of the external debt. This now hangs like an albatross around the Latin American neck. Only a handful of countries (Bolivia, Haiti, Honduras, and Nicaragua) qualify for the relief developed for highly indebted poor

countries (HIPC) by the international creditors and for the larger countries HIPC is irrelevant as it does not apply to debt owed to the private sector.

The most impressive Latin American performance has been in terms of inflation stabilization. This has been a success story with only minor qualifications,[45] as Table 2 makes clear. Given the long history of chronic inflation in many countries before 1980, this is all the more remarkable. Furthermore, the impact of adjustment programmes in the 1980s at first exacerbated inflationary pressures through the impact of currency depreciation, increases in sales taxes, and the ending of subsidies on the price level.

<Insert Table 2>

The fall in inflation rates at the beginning of the 1990s was mainly attributable to real exchange rate appreciation. The inflows of capital led to currency overvaluation that reduced inflation, but undermined external competitiveness at the same time. The classic example is provided by Argentina, where the rate of inflation fell from over 50 percent a month at the beginning of 1991 to an annual rate of less than one percent by 1996.[46] However, the cost in terms of lost competitiveness was high. The real exchange rate appreciated by anything from 30 to 50 percent depending on which domestic price deflator is used.

A fall in inflation due to currency overvaluation is not sustainable. Yet, inflation rates remained low even when real exchange rates depreciated. The reasons were both economic and psychological. Tight fiscal and monetary

policies allowed the authorities to compensate for the impact of currency falls, while trade liberalization lowered tariffs and increased competition in the tradeable goods sector at the same time. However, inflation reduction also had a psychological component. Inflationary expectations were broken in the first half of the 1990s, allowing governments to phase out indexation and making it less likely inflation would return.

This section has concentrated on the traditional measures of macroeconomic performance: growth, trade, capital flows, and inflation. However, the two decades after 1980 witnessed an important change in Latin America that consolidated a trend beginning even earlier. This was the demographic transition, under which the fall in death rates beginning in the 1920s was finally matched by a fall in death rates. Thus, the main Latin American countries faced a more manageable annual increase in population, although a number of the smaller countries such as Honduras and Nicaragua remained stuck in the first phase of the demographic transition (high birth rates and low death rates).

In the 1980s, the annual rate of growth of the population fell to an annual average of 2.1 percent and in the 1990s it fell again to 1.6 percent.[47] At the start of the new millennium, it was still falling. Since the population had been growing at nearly three percent per year in the 1960s, Latin America has achieved a big reduction in the rate of demographic expansion. The full implications of this on the environment, social spending, the labor market and pensions will take many years - if not decades - to be worked out, but it does

offer some comfort in the light of the disappointing macroeconomic performance.

Conclusions <A>

Latin America began the process of adjustment to globalization in the mid-1980s. The objectives were not only to counter the negative impact of the debt crisis, but also to reverse the disengagement of the region from the world's product and factor markets. This reversal had been a consequence of several decades of inward-looking development coupled with a growing hostility to foreign direct investment.

The goal of countering the negative impact of the debt crisis has been partially successful. Latin America did succeed in extricating itself from the debt overhang represented by commercial bank loans, but at the expense of a huge increase in bond indebtedness. In part this was due to the exchange of bank loans for bonds under the Brady Plan, but it was also due to the ease of tapping the international bond market in the 1990s.

The bond markets proved just as fickle as commercial creditors. Capital flowed to Latin America in abundance when global liquidity was strong, but the inflow proved vulnerable to events over which Latin America had no control. The Mexican financial crisis in 1994 affected all of Latin America although the circumstances in other countries were very different. The Asian financial crisis in 1997 and the Russian default the following year proved to be the catalyst for a rise in the country risk premiums in Latin America despite the lack of synchronization in the real economies of emerging

markets. Last, but not least, the terrorist attack on the United States in September 2001 led to an increase in risk aversion and a flight to quality from which Latin America inevitably suffered.

Adjustment to globalization has therefore not ended Latin America's debt problems, although they now take new forms. Debt in the 1990s increased faster than nominal GDP leading to a rise in the debt/GDP ratio. Similarly, the increase in the dollar value of exports was in many cases insufficient to reduce the debt service ratio (interest plus amortization as a share of exports). The rate of domestic saving rose, but capital formation needed to rise as well as a result of the neglect of investment in the 1980s. Thus, the gap between domestic savings and investment remained leading to a need for foreign resources.

The second objective -- integration into global product and factor markets -- was also only partially successful. The share of trade (exports plus imports) in GDP rose, but this only meant that trade was growing faster than GDP. Given the bias against exports and imports under ISI, this rising trade ratio was hardly surprising. More relevant is Latin America's share of world exports.

This share increased after 1990, but the rise is entirely explained by Mexico. Indeed, when Mexico is excluded from the Latin American figure, the ratio is virtually unchanged. Just as disturbing is the failure of all the Latin American integration schemes excluding NAFTA to increase world market share of exports in the 1990s. Latin America's export performance may have

been superior to what had gone before, but it still did not measure up against the competition from outside.

Mexico's outstanding export performance has many explanations. On the supply-side, competitiveness was increased through tax reform (including tariff reductions) and the adoption (after 1994) of a flexible exchange rate. Yet these measures were common to almost all countries in the region. What was different in Mexico's case was the demand-side. Even before NAFTA was launched, Mexico had become increasingly integrated into the North American economic space with many firms taking investment decisions on a regional rather than national basis. Direct foreign investment linked Mexico to its northern neighbor and Mexican firms began to acquire a presence in the United States.[48]

Mexico's trading links with the United States proved so strong that they dominate all Latin America's trade links. In the decade from 1988 to 1998, Latin America's exports to the United States grew at 14 percent a year compared with US imports from all sources of 7.8 percent. By contrast, Latin America's exports to the European Union, Japan and other industrial countries grew more slowly than their imports from all sources. Thus, Latin America's share of US imports increased -- mainly due to Mexico -- while its share of other markets declined. These other markets were of little importance to Mexico, but of much greater significance for the rest of Latin America.

Latin America's integration into world product markets was therefore disappointing. However, there was one notable exception -- the drugs trade.

Despite all efforts at interdiction, including crop-spraying, financial support for substitutes and draconian measures against money-laundering, the export of narcotics from Latin America continued unabated. A decline in production in one country simply led to an increase in another; a clampdown on distribution through one channel always led to the emergence of other conduits.[49] A few voices were heard calling for legalization of the drugs trade, but the importing countries were not yet ready for such drastic steps.

Latin America's integration into global factor markets was more successful than its integration into product markets. By the end of the 1990s the region's share of global direct foreign investment had risen to about 10 percent - more than double what it had been a decade before -- and DFI was spread around the region, attracted not just to Mexico but to other countries as well. The region was also well represented -- perhaps too well -- in the global bond market.

The other global factor market (labor) remained subject to major restrictions, although this had not prevented wide-scale migration from Latin America to other parts of the world -- notably the United States.[50] Migratory movements were also important within Latin America; Bolivians and Paraguayans, for example, formed a large part of the Argentine labor force by the end of the century and Nicaraguans represented at least 10 percent of the Costa Rican population. These labor movements led to a massive flow of remittances to relatives in Latin America as well as to a modest transfer of technology.

Where Latin America still lags far behind is in the knowledge economy. Its educational deficit remains severe despite high-level recognition in the 1990s of the need for accelerated investment.[51] The use of the internet is at very low levels compared with developed countries. By 2001 there were only 59 personal computers per 1,000 people compared with 286 in the euro-zone and 625 in the United States.[52] Signs of a productivity revolution inspired by the New Economy, as in North America, were conspicuous by their absence.

Thus, the long march towards globalization has not brought the benefits many expected. Growth rates have been disappointing and remain below those before 1980 in most countries. The region has opened up to foreign trade, but the basis for Latin America's renewed integration into the world economy remains unclear. Labor is abundant, but it is not cheap compared with many countries in Asia.[53] Capital is scarce domestically and can only be obtained from abroad at high cost. The region is still rich in natural resources, but the pattern of world demand and residual protectionism does not favor agricultural exports. That leaves mining exports and it is a sad comment on 500 years of economic history that Latin America's comparative advantage is still seen by many to lie with precious metals and other minerals.

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1. See, in particular, J. Ramos, *Neoconservative Economics in the Southern Cone of Latin America, 1973-83* (Baltimore, 1986).

2. There are many good studies of the debt crisis in Latin America. See, for example, R. Devlin, *Debt and Crisis in Latin America: The Supply Side of the Story* (Princeton, NJ, 1989).

3. The phrase "lost decade" was first used by the Economic Commission for Latin America and the Caribbean (ECLAC). It quickly gained acceptance as an accurate short-hand account of economic performance in the 1980s.

4. The word "globalization" is widely attributed to an article in the Economist in the mid-1980s, although the phenomenon itself is much older.

5. See Jeffrey Williamson, ed., *Latin American Adjustment: How Much has Happened?* (Washington, D.C., 1990).

6. See P. Kuczynski and J. Williamson, eds., *After the Washington Consensus: Restarting Growth and Reform in Latin America* (Washington, D.C., 2003).

7. See ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean* (Santiago, 2002), 108.

8. See the chapter by Alan Taylor in this volume.

9. On the evolution of GATT from such unpromising beginnings, see A. Winters, "The Road to Uruguay," *Economic Journal* 100, 403 (1990):

10. See W. M. Scammell, *The International Economy since 1945* (Basingstoke, 1980).

11. On the emergence of one of these tigers (South Korea), see Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (London, 1989).

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12. Developed countries continued to account for most of this trade. Even in 2000, their share of world exports was two-thirds. See IMF, *Direction of Trade Statistics Yearbook 2002* (Washington, DC, 2002), 2.

13. See World Bank, *World Development Indicators* (Washington, DC, 2003), 312.

14. The euro only came into existence as a physical currency in 2001 when it was adopted by all the members of the European Union except Denmark, Sweden, and the United Kingdom. However, the "euro-zone" is often used to describe these same countries before the euro was officially adopted.

15. See World Bank, *World Development Indicators*, 312

16. See J. Jackson, *The World Trade Organization: Constitution and Jurisprudence* (London, 1998).

17. See World Bank, *World Development Indicators,* 326-7

18. See United Nations, *World Investment Report* (New York, 2000).

19. The Hecksher-Ohlin theorem states that countries will specialise in those products that use intensively the factor of production in relative abundance. This implies that international trade between countries will take place in different products and not in the same products.

20. For the Latin American case, see Victor Bulmer-Thomas, "Regional Integration and Intra-Industry Trade" in Victor Bulmer-Thomas, ed., *Regional Integration in Latin America and the Caribbean: The Political Economy of Open Regionalism* (London, 2001).

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21. See World Bank, *World Development Indicators*, 16 and 332

22. The Asian financial crisis in 1997 and subsequent financial crises in other parts of the developing world led to a reconsideration of the merits of capital account liberalisation. For a severe critique, see Joseph Stiglitz, *Globalization and its Discontents* (New York, 2002).

23. See Victor Bulmer-Thomas, *The Economic History of Latin America since Independence*, 2nd ed. (Cambridge, 2003), chapter 11.

24. The net transfer of resources is defined as net capital inflows less payments of interest and profit remittances.

25. See Ricardo French-Davis and S. Griffith-Jones, eds., *Coping with Capital Surges: The Return of Finance to Latin America* (Boulder, 1995).

26. The net transfer of resources had once again turned negative by 2002.

27. On NAFTA, see G. Grayson, *The North American Free Trade Agreement: Regional Community and the New World Order* (Lanham, 1995).

28. See Victor Bulmer-Thomas and S. Page, “Trade relations in the Americas: MERCOSUR, the Free Trade Area of the Americas and the European Union,” in Victor Bulmer-Thomas and James Dunkerley, eds., *The United States and Latin America: The New Agenda* (Cambridge, MA, 1999).

29. See Bulmer-Thomas, *Regional Integration in Latin America*, 85.

30. See ECLAC, *Statistical Yearbook for Latin America and the Caribbean* Santiago, 2002), 341.

31. On all these regional integration schemes, see Bulmer-Thomas, *Regional Integration in Latin America.*

32. Intra-regional trade in MERCOSUR was particularly badly hit by the Argentine financial crisis in 2001/2, when imports were reduced by 60 percent.

33. See World Bank, *World Development Indicators*, 262-64. The ratings quoted are those awarded by Standard and Poor.

34. These American Depositary Receipts were deemed to be much more liquid and were therefore popular with foreign investors. For US investors, they had the additional advantage of avoiding exchange rate risk.

35. The most important of these tax breaks was the Caribbean Basin Initiative (CBI), first introduced in 1984. This led to a boom in assembly plants in many countries, but a number of factories transferred production to Mexico after the adoption of NAFTA.

36. This has been particularly true of Argentina and Brazil, where maxi-devaluations in 2001/2 did not lead to a permanent increase in inflation as had originally been feared.

37. On the impact of social spending on income distribution, see the chapter by Andrés Montes and Miguel Székely in this volume

38. For a case study of Chile, see C. Scott, "The Distributive Impact of the New Economic Model in Chile," in Victor Bulmer-Thomas, ed., *The New*

Economic Model in Latin America and its Impact on Income Distribution and Poverty (New York, 1996).

39. The Dominican Republic, however, suffered a major banking crisis in 2003, leading to a collapse of the exchange rate and a fall in real GDP.

40. The collapse of Argentine GDP in 2002 (it fell by 11 percent) wiped out the long-run improvement in GDP per head that had been achieved in the first half of the 1990s.

41. Mexico has made a big effort to diversify its trading links, signing free trade agreements with other Latin American countries as well as with the European Union. However, the gravitational pull of the United States has proved irresistible and the links with the United States have, if anything, grown stronger.

42. See M. Mussa, *Argentina and the Fund: from Triumph to Tragedy* (Washington, DC, 2002).

43. The difficulties facing Brazil were compounded by the 1988 Constitution creating state obligations in the area of social security that were increasingly onerous. These could only be tackled through constitutional reform, which became a priority for the government of President Lula (2003-).

44. This ratio fell again, however, at the start of the new century as a result of the decline in DFI to Latin America.

45. The most important exception has been Venezuela, where inflation remained in double-digits for almost all of the period since the debt crisis.

46. Argentina even had price deflation between 1999 and 2001. See ECLAC *Statistical Yearbook*, 741.

47. See Bulmer-Thomas, *The Economic History of Latin America*, 7, Table 1.2.

48. Mexico's privileged position could not prevent increased competition from China. The entry of the People's Republic into the World Trade Organization at the start of the new millennium led to some investment diversion from Mexico to China and much greater competition for Mexican exports in the United States.

49. An example is *Plan Colombia*, adopted with the support of the United States in Colombia. By 2003, it was clearly succeeding in its aim of reducing coca cultivation and shipments of cocaine to the United States, but total coca production in Latin America was largely unaffected.

50. Remittances to Latin America by migrants living abroad were estimated at over $30 billion by the beginning of the twenty-frist century. In some countries, they reached nearly ten percent of GDP.

51. See the chapter by Fernando Reimers in this volume.

52. See World Bank, *World Development Indicators*, 300.

53. This point is made in some detail in the chapter by Andrés Montes and Miguel Székely in this volume.